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Finally the IRS Issues Needed Guidance on SECURE Act 2.0 Changes for SIMPLE-IRA Plans

On December 20, 2023 the IRS finally issued guidance regarding various law changes in the SECURE Act 2.0 impacting SIMPLE-IRA plans. Some of these changes are effective for the 2023 tax year. There are three sections within SECURE Act 2.0 with law changes for SIMPLE-IRA plans. These are sections 112, 601 and 332.

Change #1 from Section 601. Roth SIMPLE-IRA Contributions

The IRS clarifies that an employer which sponsors a SIMPLE-IRA plan is not required to amend its plan to offer its eligible employees the right to designate his or her elective deferral contribution or the employer's matching contribution or the employer's nonelective contribution as a Roth contribution. The employer has the right to write the plan to require that all contributions be traditional contributions Congress hopefully will confirm that the IRS position is what Congress intended.

If an employer amends its respective plan to allow its employees the right to elect to have the employer contribution be a "Roth" contribution, then an employee must have the right to decide whether his or her elective deferrals will be standard deferrals, Roth deferrals or a combination of both.

An employer can make a Roth contribution on behalf of an employee only if the employee has previously made his or her election that a Roth contribution is desired.

The IRS does not require that there be a second Roth SIMPLE-IRA, plan agreement. The law and the IRS require that a separate account is established for all Roth SIMPLE-IRA contributions and related earnings or losses. In many cases there will be improved administration capabilities if a separate Roth SIMPLE-IRA is established.

Once a Roth SIMPLE-IRA contribution is made that contribution type cannot be changed or corrected. It is irrevocable.

An employee who elects to make a Roth SIMPLE-IRA elective deferral is required to include such contributions in taxable income for the year the payroll is paid.

The employer may make its Roth SIMPLE-IRA matching contribution or Roth SIMPLE-IRA non-elective contribution the same year or it might be made the following year An employee is required to include such contributions in taxable income the year the employer makes this type of contribution.

When an employee elects to make a Roth SIMPLE-IRA elective deferrals those deferrals are subject to income tax withholding, FICA and FUTA

When an employer makes a Roth matching contribution or a Roth nonelective contribution such amount are not subject to income tax withholding, FICA and FUTA.

Continued on page 2

Changes for SIMPLE-IRA,
Continued from page 1

The employer has the duty for each employee to report these contribution types. The employee will be informed of his or her Roth elective deferrals on Form W-2 and the Codes For Swill be used. The employer's matching or nonelective contributions will be reported on Form 1099-R.

Change #2 from Sections 116 and 117. Increase in SIMPLE-IRA Contribution Limits.

Section 116 permits an employer to make an additional nonelective contribution to eligible employees. This additional contribution may be up to 10% of compensation, but it is limited to $5,000 for each employee. The IRS does not indicate when this change was effective, but it is effective for 2023.

Section 117 increases for certain employers the annual limit applying to elective deferrals and the annual limit for making catch-up contributions for persons age 50 or older. The increased limits are 110% of the otherwise applicable limits for 2024. Thus the two limits applying for 2024 to individuals under age 50 are $16,000 and $19,500 and the two limits applying to individuals age 50 or older are $17,600 and $21,450.

This increase in the limits are automatic for some employers. This increase in the limits are automatic for an employer that has no more than 25 employees who received at least $5000 of compensation for the preceding calendar year.

This increase in the limits will apply to an employer that has more than 25 employees who received at least $5000 of compensation for the preceding calendar year only if the employer so elects. An employer who elects to have the new higher limits apply must increase its matching contribution to be 4% of compensation rather than 3% or the employer must increase its nonelective contribution from 2% of compensation to be 3%.

In determining whether the 25 employee limit is met or exceeded an employer must consider all employees regardless if they are eligible to participate in the SIMPLE-IRA plan. There generally is a 2 year grace period for the 25 employee limit. The grace period does not apply if the increase in the number of employees is on account of an acquisition, or similar transaction.

An employer must notify its eligible employees of the increased limits. This information must be set forth in the annual employer notification. If an employer had to make an election and made such election, it stays in effect until it is revoked by the employer.

The IRS does not discuss how the notice was to be furnished for 2024 by an employer who was not required to make any election. CWF recommends sending out a special notice now.

The IRS does discuss how the notice requirement applies to an employer who must make the election to have the increased limits. The IRS states that an employer must make the election before the employer provides the annual notice. This seems to state that an employer will not be able to use the new limits until 2025. Employers will need to discuss and rely on their tax advisers. The fact that the IRS was late in furnishing necessary guidance should not mean that the new limits do not apply for 2024.

Change #3 from Section 332. Replacing A SIMPLE-IRA Plan Mid-Year With a Section 401(k) Safe Harbor Plan.

The law has been changed effective in 2023 so that at any time during the year an employer may terminate its SIMPLE-IRA if the employer adopts as a replacement plan a safe harbor section 401(k) plan. The existing law that an employer is unable to terminate its SIMPLE-IRA plan midyear continues to apply with this one exception. The SIMPLE-IRA plan is replaced with a safe harbor 401(k) plan.

In order to terminate a SIMPLE-IRA plan an employer must adopt a formal written document which specifies the plan's termination date. An employer must notify its employees at least 30 days before the termination date. The employees must be notified that there can be no elective deferral contributions made with respect to compensation earned after such termination date and that an employer remains obligated to make its matching contributions or nonelective contributions for the period prior to the termination date. An employer should also notify the SIMPLE-IRA custodian and payroll provider. An employer must keep the records relating the plan's termination.

Once the plan is terminated there is now a new rule

Continued on page 8

Finally the IRS Issues Needed Guidance on SECURE Act 2.0 Changes for Roth SEP-IRAs

On December 20, 2023 the IRS finally issued guidance in Notice 2024-02 regarding various law changes in the SECURE Act 2.0 impacting Roth SEP-IRA plans. These changes are effective for the 2023 tax year. The section authorizing these changes is section 601. These changes could be implemented in 2024 for the 2023 tax year.

The IRS does not discuss Roth SEP-IRA plans for one person plans. We are not aware of any law which prohibits a one person business from having Roth SEP-IRA plan. The maximum per person SEP-IRA contribution for 2023 is $66,000 and it is $68,000 for 2024. We expect many successful small business owners will switch from making traditional SEP-IRA contributions to making Roth SEP-IRA contributions. Such contributions will need to be segregated.

The IRS clarifies that an employer which sponsors a SEP-IRA plan is not required to amend its plan to offer its eligible employees the right to designate the employer contribution as being a Roth SEP-IRA contribution. An employer has the right to write the plan to require that all contributions be traditional SEP-IRA contributions Congress hopefully will confirm that the IRS position is what Congress intended.

If an employer amends its respective plan to allow its employees the right to elect to have the employer contribution be a “Roth” contribution, then an employee must have the right to decide if the employer contribution will be a Roth SEP-IRA contribution, a standard contribution or both.

An employer can make a Roth contribution on behalf of an employee only if the employee has previously made his or her election or instruction that some or all of the employer’s SEP-IRA contribution is to be designated as a Roth SEP-IRA contribution.

An employer must provide an employee a reasonable amount of notice and time to make his or her decision and furnish his or her instruction.

The IRS does not require that there be a second Roth SEP-IRA, plan agreement. The law and the IRS require that a separate account is established for all SEP Roth IRA contributions and related earnings or losses. In many cases there will be improved administration capabilities if a separate Roth SEP-IRA is established.

Once a person makes his or her election or instructions that his or her contribution will be Roth or non-Roth the contribution type cannot be later changed. It is irrevocable.

On a prospective basis an employer is permitted to allow an employee to change their instruction.

An employee who elects to make a Roth SEP-IRA contribution is required to include such contribution in taxable income for the year the employer makes the contribution.

An employee who elects to have the employer contribution be a Roth SEP-IRA contribution should understand that the IRS’ position is these contributions are subject to withholding and FICA and FUTA. Therefore, an employer has the duty for each employee to report these Roth SEP-IRA contributions in boxes 1, 3 and 5 of Form W-2.

We at CWF will be revising our SEP-IRA forms to reflect these new laws.

The IRS in Notice 2024-02 states in Q/A K-7 that an employer may institute a Roth SEP-IRA plan even though the IRS has not yet modified or updated IRS Form 5305-SEP or the rules for a SEP prototype. The current Form 5305-SEP or a SEP prototype my continue to be used until the IRS issues new forms or provides new guidance.

The IRS has given no indication that Form 5498 will be revised so that the IRS will be informed what portion of the employer SEP contribution was a regular contribution and what portion was a Roth SEP-IRA contribution. The individual will need to explain things correctly on their income tax return.

Email Guidance – Roth IRA Distributions

Q-1. I have a lady in her 30's that has a Roth IRA. She is asking if she can withdraw money from this account to be used to purchase a home. I am not sure if she is a first time home buyer or not. She is married but not sure if she owns the house she is in or if just her husband owns it. She has $29,000.00 in the Roth IRA. Just wasn't sure how to answer this question. I would appreciate your help on this.

A-1. Here is my understanding. I ask that she confirm with her tax adviser or accountant. There are special tax rules that grant a person special tax benefits when the person withdraws Roth IRA funds and then uses those funds for a purchase of a first home.

I will discuss the basic Roth IRA distribution rules and the special rules.

The basic Roth IRA rules state that Roth IRA funds are withdrawn in the follow order- annual contributions are withdrawn first, then any conversion contributions are withdrawn and then any earnings are withdrawn last. The earnings may or may not be table. The withdrawal of a person's own contribution are never included in income.

A Roth IRA distribution is qualified (tax-free) if a person has met the 5-year rule and the person is age 59½ or older, disabled or withdraws no more than $10,000 for a first time home purchase.

A Roth IRA distribution is also qualified (tax-free) if a person is a beneficiary and the 5-year rule has been met.

For discussion purposes I am going to assume she has made contributions of $25,000 and she has had earnings of $4,000.

She may withdraw $25,000 for any reason and she is not required to include any of the $25,000 in her income because she is withdrawing her own contributions for which she was given no tax benefit when she made the contribution. The 10% additional tax when someone is under age 59½ only applies if the amount being withdrawn is taxable.

If she withdraws some or all the $4,000 of earnings (i.e she withdraws the entire $29,000) she would be required to include the $4,000 in income because she is under the age of 59½. Although she is under age 59½, she will not the additional 10% tax because the law has an exception for this situation.

In actuality the special Roth rule for a first time home buyer only applies only in limited situations. It only applies when the distribution is $10,000 of less. The IRS has furnished very little guidance on this special Roth IRA rule. The law should be clarified or amended to provide that the first $10,000 of earnings, if withdrawn will be tax-free. If she would withdraw the $29,000 I understand she would need to include in her income the earnings portion but she would not owe the 10% additional tax.

Q-2. We received a check for one of our customers for a direct rollover to an IRA. The check is made out like this:

Pay to the order of :

ABC Bank & Trust

FBO-Customer name

AS Benef of (his moms name)

For the account number he put down his Roth IRA number, can he put this in a Roth IRA or does it have to be a traditional beneficiary IRA?

The check is from The State of Oregon Public Service Retirement Plan.

A-2. You have an interesting situation from a tax standpoint and a be careful situation.

You don't mention the amount of the check.

Your customer as a beneficiary of deceased participant of an employer sponsored retirement plan has the right to instruct on a special distribution formed furnished by the plan administrator to have direct rollover into an inherited traditional IRA or an inherited Roth IRA.

Does he have a copy of the distribution form he was provided and completed? Might he have a copy for the bank's file?

Continued on page 5

Roth IRA Distributions,
Continued from page 4

He does not have the right to have a direct rollover into a traditional IRA or a Roth IRA. He cannot add it to his existing Roth IRA or an existing traditional IRA. It must go into either an inherited Roth IRA or an inherited traditional IRA.

It would have been best if the check clearly indicated into what type of IRA the funds were to go into. The law is somewhat murky on this subject, but I believe the plan administrator has that duty, but has not performed this duty. The plan administrator will prepared its Form 1099-R to report the distribution to him one way if the funds are going into an inherited Roth IRA and a different way if the funds are going into an inherited traditional IRA ..

Has your customer talked with his tax adviser? I get the idea the plan administrator may not have explained the situation as well as should have been done. I don't what your customer understands or doesn't understand. Your customer may mistakenly think he does not need to pay taxes on this transaction and the funds can go into his Roth IRA and earn tax-free income for many years.

If your customer puts the funds into an inherited Roth IRA that amount will be income on his 2023 tax return. As a beneficiary he will have 10 years to close this inherited Roth IRA. He is not required to take any distribution for years 1-9, but he must close it in year 10. Any income earned by the inherited Roth IRA will be tax-free once he has met the 5-year rule.

If your customer puts the funds into an inherited traditional IRA that amount is not taxed on his 2023 tax return. How old was the person who died? Did the person die before or after his or her required beginning date? Call me at 1-800-346-3961 so we can discuss the applicable rules.

The bank will need to prepare a Form 5498 showing this direct rollover in box 2 on his Form 5498 with the special titling - his name as beneficiary of the decedent's name.

A-2-A. You may show him my emails, but he must rely on his own tax accountant.

He would not owe current taxes if he directly rolls over the funds into an inherited traditional IRA.

He would owe current 2023 taxes if he directly rolls over the funds into an inherited Roth IRA. My guess is that he would owe approximately $7600 (22%).

Again, I don't know what he understands the tax rules to be. It may be he understands these rules and he has decided he wants the funds to go into an inherited Roth IRA.

Email Guidance – QCD Question

Q-1. We have a client who wishes to make a QCD this year and there is a question about the 1099-R reporting for our participant. As the IRA custodian we are still responsible for entering the total amount of all distributions in the taxable amount section of the 1099-R regardless of if it is a QCD on her 1099-R correct? And then will the participant reduce her taxable income on her return based on the tax receipt they will receive from the charitable organization?

A-1. You are correct. An IRA custodian reports the distribution as a normal reason code 7 IRA distribution on the Form 1099-R and the individual must explain on her or his tax return that the distribution is not taxable because it was a QCD.

I have sent you the portion of the IRS instructions to an IRA custodian for completing the Form 1099-R.

The individual should review the instructions for completing lines 4 and 4b on his or her Form 1040.

Although an individual might think the IRS would have a special code for a QCD, the IRS does not have a special code or a way that the IRS is informed by a third party that a person has made a QCD. The individual has the duty to explain she or he has made a QCD.

Email Guidance – Inherited IRA can NOT be Pledged as Collateral

Q-1. I was told that we could do a loan on an inherited IRA/retirement plan. The client lost both parents and inherited part of her mom's 401(k). I have read up a little on it and she will need to draw it out within 10 years and pay income taxes on the amount withdrawn annually. I was told by an attorney that we could lend on this inherited IRA but I know in the past we could never lend on retirement money. Do you know anything about these and if we can legally lend on them?

A-1. It is still impossible to use any IRA, regular or inherited, as collateral for a personal loan or any loan.

If an attorney or accountant has something in writing supporting the position that an inherited IRA can be used as collateral, I will review it. But that attorney is wrong.

The tax rule still is, an individual must include in their income the amount which is pledged. The amount is no longer authorized to stay in the IRA so it must be withdrawn as an excess contribution from the IRA.

Pledging an IRA as collateral is a prohibited transaction. The general rule is when a prohibited transaction occurs the IRA is a deemed distribution as of the first day of the current year. The law is not as harsh when there has been a loan. The amount deemed distribution is the amount pledged and not the entire IRA amount.

Email Guidance – Inherited IRAs

Q-1. I have a silly question. For Inherited IRA's, when we distribute from the deceased IRA into the Inherited, is there a signature required on that deceased IRA's Distribution Form?

A-1. The beneficiary on a distribution form or a contribution form instructs (and signs) that the IRA funds are to be transferred (internally) from the decedent's IRA into the inherited IRA for the beneficiary.

There needs to an authorization - it would be best if the beneficiary signs, but an oral authorization is acceptable if noted on the forms. Note that the CWF form authorizes the IRA custodian to make this transfer should a beneficiary be slow to act.

Q-2. I have our first situation where an Beneficiary of an original IRA owner has now passed. The original accountholder passed in 2019 at the age of 93. She named her son as one of the beneficiaries, he has now passed at the age of 67 and his wife was his sole beneficiary. She would like to keep the account and continue to take distributions. Are these distributions now based upon her life expectancy or the original beneficiary? Does the account now need to be closed by the end of 2030? (10 years since the original accountholder passed away)

A-2. Here is my understanding. The original IRA owner died at age 93 in 2019 after her required beginning date.

Any beneficiary of an IRA owner who died before 2020 is defined to be an EDB. He elected to use the life distribution rule.

How old was the son in 2020? I understand he was age 64. The divisor from the Single Life Table for a person age 64 is 23.7 years. This was the divisor for 2020.

His beneficiary is required to continue his schedule, but the 10-year rule also applies so this inherited IRA must be closed by 12/31/2033.

His divisor schedule and the schedule for his beneficiary (including a spouse) is:

2020	23.7	
2021	22.7	
2022	21.7	
2023	20.7	Son Beneficiary dies
2024	19.7	
2025	18.7	
2026	17.7	
2027	16.7	
2028	15.7	
2029	14.7	
2030	13.7	
2031	12.7	
2032	11.7	
2033	1.0	

Continued on page 7

Inherited IRAs,
Continued from page 6

So, she does have RMDs for 2024-2032 and she must close the inherited IRA by 12/31/33. She will want to decide, should I withdraw more than the RMD for years 1-9 to lessen the income taxes to be paid in 2033 (year 10)?

If he had not withdrawn the RMD for 2023 prior to his death she should withdraw at least that amount by 12/31/2023.

Q-3. I am working on a beneficiary IRA and wondering how to handle the RMD. The deceased account holder died on December 29, 2022. We did not know about her death until 2023. The sub accounts were opened on 2/16/2023. The deceased died after her RBD and beneficiary is not a spouse or EDB. I understand that the beneficiary can use the lifetime distribution. My question is, since there was no FMV, because the money was moved in 2023, instead of 2022, will she be required to take a distribution this year or in 2024?

A-3. I understand that the IRA beneficiary did have a FMV with respect to an inherited IRA as of 12/31/2022 and so the beneficiary has an RMD for 2023.

The IRS RMD rules don't depend upon when an IRA custodian sets up the inherited IRA on its IT system. If the IT system makes this calculation, there should be a procedure to replace or override the 0.00 with the amount as of 12/31.

A non-EDB of an IRA accountholder who has died after their required beginning date will have an RMD for years 1-9 and will also be required to close the account in year 10. See the attached for the special relief granted by the IRS for such RMDs for 2021-2023.

The beneficiary's initial divisor is based on how old the beneficiary is in 2023 and then refer to the single life table.

Q-4. Customer had an IRA with us and died 11-25-2020. she was in RMD as she was age 93 in 2020.

Her daughter was the beneficiary for the ½ of the IRA and opened a beneficiary IRA with us 12-18-2020.

I visited on this issue back in 2020 as to how to handle this account. At that time I was told she had 10 years to take out the balance of the IRA.

But I am learning/hearing different opinions on this issue.

Can you clarify for me this issue?

Is she to have been taking IRA RMDs every year since 2020?

Is the 10-year total payout ok? (I mean no withdrawals until 10th year?)

A-4. The IRS issued its proposed RMD regulation in February of 2022. The IRS is adopting the approach that when an IRA accountholder dies after her required date, the daughter as a non-EDB must take annual RMDs for the first 9 years and also must close the inherited IRA in year 10. The daughter does not have the right to not take any distribution for years 1-9.

The IRS understands that many individuals may not have understood the IRS would be adopting this approach. So, the IRS has granted relief for years 2021-2023. Technically an RMD should have been taken but the IRS has said - we won't collect the RMD tax if a person has not withdrawn their RMDs for 2021, 2022 or 2023.

I have sent you a copy of a newsletter article discussing that the IRS has granted relief for RMDs required during 2021 - 2023.

I have sent another article discussing the new rules.

Q-4A. Thanks for the information you sent - that really helped.

1. When calculating the RMD for year 2021 for example: that is calculated using 12-31-2020. I understand that one. But when you go to calculate the 2022 distribution do you decrease the 12-31-21 balance by the distribution that should have taken place? Or just use the 12-31-21 balance to calculate the 2022 distribution? Same would go for the 2023 distribution.

2. What is the penalty to not take the distributions for 2021, 2022 and 2023? Is it still 50% of what should have been taken as an RMD? I thought I read the penalty for not taking went down? Maybe I am dreaming ...

A-4A. You use the actual FMV as of 12/31/2020, 12/31/2021, 12/31/2022. You do not modify or adjust the FMV because of a missed RMD.

The newsletter I sent states that the IRS will not collect the RMD tax for failing to take RMDs in 2021, 2022 and 2023. If a beneficiary wants to get caught up by taking 2 or 3 distributions this year, the beneficiary may do so

Continued on page 8

but a beneficiary need not withdraw their 2023 RMD because the IRS has said it won't try to collect the RMD tax.

The RMD tax is now 10% if a person fails take her RMD in 2023 and subsequent years and pays this 10% tax on time. The 10% increases to 25% if a person fails to pay that 10% and the IRS figures it out and contacts the person. The IRS has not waived collecting the tax for all persons who have missed RMDs in 2023, only certain beneficiaries.

Q-5. We have a customer who recently passed away who had 1 Trad IRA with us. She has 2 beneficiaries, both of her sons. What are their options here with the funds? Does it have to go into an Inherited IRA or can they cash it out?

A-5. To help I need to be provided more information.

A Form 1099-R must be prepared whenever you make an IRA distribution to someone. Technically, the bank is not required to set up an inherited IRA for a beneficiary who withdraws 100% of their share of an inherited IRA. By law when an IRA accountholder dies their IRA becomes an inherited IRA regardless if the bank has set it up on its IT system as an inherited IRA. For most banks an inherited IRA must be set up for a beneficiary in order to get the Form 1099-R prepared in the beneficiary's name. Some banks are able to prepare that Form 1099-R without setting up an inherited IRA.

For any IRA beneficiary situation one wants to ask and have answers to the following questions?

1. Did the IRA accountholder die before or after his or her required beginning date? The RBD is the April 1 of the year following the year a person attains the RMD age of $70^1/_2$, 72 or 73.

2. What is the date of birth of the beneficiary?

3. Is the beneficiary an EDB or not an EDB?

See the attachment which summarizes the RMD rules applying to beneficiaries. See CWF Forms 204 and 206.

Please call if you wish to discuss. It is certainly easiest for the bank if a beneficiary takes a lump sum distribution, but for income tax reasons the beneficiary may not want a lump sum.

Q-5A. So her sons would be able to just cash out her IRA and transfer the funds into their name, their ages are 61 and 68.?

I would just need to use the correct form and code it correctly on our end for tax purposes.

A-5A. Yes, a son beneficiary may withdraw his share of the IRA. Each son will need to include in his taxable income the amount he receives. Each son is to receive a Form 1099-R. ·

Changes for SIMPLE-IRA,
Continued from page 2

that permits a participant who has not met the 2 year rule but who has taken a distribution to rollover their SIMPLE-IRA funds into the new safe harbor 401(k) plan. This is the only exception to the 2 year rule which provides no rollover is authorized if the 2 year rule has not been met.

An employer will have the duty to furnish a new notice (summary description) to the participants of the safe harbor 401(k) plan describing their rights to make elective deferrals, including what is the maximum amount which may be contributed for the remainder of the year.

A person will have to determine what their maximum contribution amount is. A 401(k) plan has a higher limits than the SIMPLE-IRA plan. The total contribution amount to the safe harbor section 401(k) plan is equal to:

(1) The annual contribution limit for a SIMPLE-IRA plan, including any catch-up multiplied by a fraction equal to the number of days the SIMPLE-IRA plan was in effect divided by 365, plus

(2) The annual 401(k) contribution limit for a 401(k) plan, including any catchup amount multiplied by a fraction equal to the number of days the 401(k) is in effect divided by 365, minus

(3) Any SIMPLE-IRA contributions made for the year.

Although the law has been changed to allow an employer to replace its SIMPLE-IRA plan with a safe harbor 401(k) plan, many small employers may for simplicity reasons I choose to terminate its 401(k) plan and replace it with a SIMPLE-IRA plan. That change, however, may not take place midyear.